Japan's Growth Strategy & Fiscal Sustainability

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1. The Historical Positioning of Growth Strategy: an Antidote to End Times Apocalyptic Fascism

In July 2026, the Japanese government decided to push forward with public and private investments exceeding 370 trillion yen by 2040 in 17 strategic areas, including AI and semiconductors, as part of the "Japan's Growth Strategy". Pursuing economic growth has always been a standard goal of economic policy. But nowadays, the importance of a "growth strategy" comes from a deeper sense of stagnation and structural challenges unique to our era, beyond just the issue of boosting GDP numbers.

Right now, mainly in the West, there's a rising trend of far-right, religious populism that could be called "end times fascism". At first, it might seem a bit removed from the Japanese context, but to understand the issues our country is facing, we need to start by unpacking this concept. The main reasons behind this phenomenon shaking the West are things that also potentially exist in Japan today.

End times fascism is a political phenomenon that arises from dissatisfaction with extreme inequality, set against the backdrop of the collapse of the white middle class and existential crises – such as environmental issues, nuclear threats, and AI risks – that could potentially lead to human extinction. The masses, angry about inequality, crave a strong leader or a scapegoat for their frustration, and as a result end up tolerating authoritarian rule. Meanwhile, dictatorial leaders and tech ultra-rich riding the AI wave turn their backs on solving the existential crises facing ordinary people, retreating into fortified isolated cities or private islands to try to secure survival for themselves alone (Klein and Taylor, 2026).[1] Klein and Taylor point out that the complete divide between this ruling class and the general public, along with the "denial of humanity" of the average person by the leaders, is what is on the verge of becoming a dystopian reality today.

To maintain sustainable stability in the economy and society, a "detox" to stop the advance of this apocalyptic fascism is essential. It has to be something that effectively corrects the extreme inequalities that modern society is facing. That's because strong public dissatisfaction with extreme inequality strengthens popular support for fascism and populism, allowing their influence to grow. Japan shares the same issue of widening inequality. On top of that, Japan also has the problem of a general decline in living standards due to years of economic stagnation.

To tackle these issues, pursuing "growth" emerges as one possible option. Trying to quickly and directly correct disparities often carries the risk of falling into centralized, controlled economic methods. Klein and Taylor (2026)[1] argue for the effectiveness of a modern "New Deal" policy, but policies that focus too much on pure redistribution can lead to excessive state intervention in the market, which could end up sapping the economy's vitality.

We (Japan or the world) can't survive without a free and open global economic system. Global inequality is an undeniable evil, but if we try to fix it by rejecting the free market economy itself, we'd be making the mistake of "throwing out the baby with the bathwater".

So, what we need to recognize is that "one antidote to apocalyptic fascism that can coexist with a free market economy is a growth strategy." By creating sustainable wealth through a growth strategy and using it to inclusively ease and correct disparities, raising the overall standard of living for everyone, we can fundamentally heal the anxieties of the masses that lean toward populism or fascism.

This kind of thinking – that is, the approach of "achieving economic growth through policy intervention, and thereby maintaining and developing a free economic society" – can be called "Growth-oriented Liberalism". This is quite different from the usual demand-stimulating active fiscal policy. Active fiscal policy for growth is a promising option for reviving liberalism in today's world, which faces the threat of apocalyptic fascism.

2. The Dilemma Between the Effectiveness of Growth Strategies & Fiscal Sustainability

Can aggressive fiscal policies actually lead to long-term economic growth? Traditional mainstream macroeconomic theories are either skeptical about the long-term growth effects of fiscal spending or have just ignored that possibility from the start. But recent empirical studies are starting to show that the right kind of fiscal policy can boost long-term economic growth.

For example, according to a study by Antolin-Diaz and Surico (2025),[2] increased funding for research and development (R&D), as represented by the Defense Advanced Research Projects Agency (DARPA) of the US Department of Defense, has been shown to significantly boost long-term economic growth. Just like how DARPA's communication systems eventually developed into the Internet, this is a clear example of how military and advanced research can have huge technological spillover effects into the civilian economy.

However, fiscal policy (in the context of this paper, industrial policy) doesn't necessarily boost economic growth. Especially considering our country's past experience (there's a lack of notable success stories), we can't help but say that the hurdles to overcome are really high. The lessons we should take from past cases can basically be summed up in two main points.

• **Eliminating competition breeds corruption:** The government doesn't have the ability to predict the market or pick winners. If you protect certain companies and eliminate competition, organizations will inevitably become corrupt. Instead, you need a contest-style system that encourages fierce competition among companies eligible for subsidies and concentrates financial resources on the promising ones through a survival-of-the-fittest process.

• **Advantages of investing in research and education:** Instead of arbitrarily supporting specific individual companies, providing financial support for broad foundations like basic research, education, and human resource development tends to give a higher return on investment for society as a whole.

In other words, only when financial resources are effectively allocated in a competitive and transparent market environment can fiscal spending truly lead to higher productivity and trigger private investment.

But there's a big dilemma here. If government spending piles up debt, we might eventually have to give up on growth policies themselves just to keep the government debt sustainable.

So, how sustainable is our country's government debt? Several studies from over a decade ago using standard neoclassical models suggested that in order to make fiscal policy sustainable, it would require about a 14% improvement in the fiscal balance relative to GDP (essentially turning the primary balance into a surplus). That's roughly equivalent to raising the consumption tax rate by around 30%. Moreover, a more recent analysis (R. Anton Braun, Aug. 24, 2026, in the *Nihon Keizai Shimbun 'Keizai Kyoshitsu'*) points out harshly that we still need to raise the consumption tax rate to 25%.

If achieving such a huge fiscal surplus is absolutely necessary, then keeping an active growth strategy would become impossible, and the policy would end up in a "no-exit" situation.

But we need to pause for a moment and question the assumptions behind the usual arguments. The view that a large fiscal surplus is essential is based on the common notion that "the value of government debt must be fully backed only by future fiscal surpluses", meaning it assumes **"the value of government debt equals the discounted present value of future fiscal surpluses."** But what if government debt actually has **"additional value"** that's different from future fiscal surpluses?

3. New Horizons for Fiscal Sustainability

As we saw in the previous section, if we stick to the standard view that treats the value of government debt solely as the "discounted present value of the stream of future fiscal surpluses", then managing our country's finances with such a huge accumulated debt seems like a dead end. But in recent years, there's been a drastic paradigm shift in macroeconomics and finance regarding fiscal sustainability. At the heart of this shift is the rediscovery of the fact that government bonds aren't just "bonds that are repaid with interest", but actually provide an "intrinsic value" beyond just principal and interest payments.

Specifically, for example, government bonds provide market participants with the following three additional values:

• **Providing liquidity:** They serve as a stable and readily cashable means of settlement in the financial markets, functioning as top-notch "collateral" in a wide range of repo and derivative transactions.

• **Offering an insurance function:** In macroeconomic environments with extremely high volatility, they act as safe assets with stable value, serving as a hedge against various risks in society.

• **Providing a stable savings option:** In a society facing an aging population and a lack of private investment opportunities, when there are no other assets offering appropriate returns, they become a safe long-term investment destination.

Because these functions are priced in the market as their own "value", the market value of government bonds will always exceed the "discounted present value of future fiscal surpluses" in theory. Therefore, even if the government doesn't necessarily achieve large fiscal surpluses, or if a baseline fiscal deficit continues, it's theoretically possible for government bonds to maintain high value.

A prime example of this new approach to fiscal sustainability is the dynamic theory of "safe assets" proposed by Markus Brunnermeier, Sebastian Merkel, and Yuliy Sannikov (Brunnermeier, Merkel, and Sannikov, 2024).[3]

Looking at the finances of major countries, you could say that reality actually proves the validity of this theory. There hasn't been any major advanced country – not Japan, the United States, or any European nation – that has consistently maintained a fiscal surplus

over the past several decades. Japan and the US have had persistent budget deficits, and European countries, even while enforcing strict fiscal rules, have also accumulated deficits. Yet in none of these regions has there been a catastrophic event like a collapse of the government bond market. If the value of government bonds were determined solely by "future fiscal surpluses" as a fundamental condition, it would be impossible to explain how bonds from major countries, where deficits are expected in the future, can still maintain high value.

Brunnermeier and others thought that the reason major countries' government bonds remain stable is that they have non-fundamental value coming from functions like "liquidity, insurance, and a means of saving", which means a kind of "stable bond bubble" keeps forming in the market. They also theoretically proved that this bubble-like value isn't just temporary, but can be maintained indefinitely within a general equilibrium model.

The most insightful finding their theory presented is that even if there's an ongoing fiscal deficit, as long as the government clearly commits to a sustainability defense – saying that "in the unlikely event of an emergency where government bond values drop, we will immediately shift to proactive tax hikes or spending cuts to ensure a fiscal surplus and firmly support bond values" – and the market believes in that commitment, then a government bond bubble won't collapse.

That said, this result doesn't mean we can just keep increasing the fiscal deficit as much as we want. In a quantitative analysis modeled on the US economy, Brunnermeier and others[3] showed that if the fiscal deficit is around 2% of GDP or smaller, government bond prices can remain stable. By the way, Japan's current primary balance (PB) is running a deficit of just under 1% of GDP. In recent years, a growing body of studies also pointed to the existence of a government bond bubble beyond Brunnermeier and others. These studies offer two important lessons for Japan's growth strategy and future fiscal management.

First of all, even if we don't rush to implement huge tax hikes or create massive fiscal surpluses, as long as reasonable and flexible fiscal discipline is maintained, fiscal stability will last. So, there's still plenty of room to boldly direct fiscal resources toward the growth-strategy investments needed to realize a "growth-oriented liberalism", like R&D and investment in people.

Second, under a fiscal deficit, the condition to ensure the stability of government bond values is that the government's commitment to sustainability – "we'll achieve a fiscal surplus when it really counts" – is trusted by the market. Or, as ongoing research by Tomoyuki Nakajima and I shows, even if a large, permanent surplus isn't possible, if the PB can be maintained as at least a very slight surplus over the long term, the market value of government bonds remains stable at a high level. Fortunately, Japan today is roughly achieving a balanced PB (almost zero). So, the goal of "stably maintaining a tiny PB surplus" is by no means unrealistic.

No matter which path we take, the most important thing is that the market keeps believing in the government's willingness and ability to sustain its finances. If the government can build a regime that earns this kind of financial trust, it's entirely possible to push forward a bold and appropriate growth strategy while keeping fiscal sustainability stable and avoiding the risk of a government bond crash.

So how can the government get the market to trust its commitment to fiscal sustainability? For this, we need to set up some institutional frameworks. Specifically, creating an independent fiscal institution seems to be a promising approach. An independent fiscal institution is a public organization consisting of economic and fiscal experts who, in a politically independent position, make long-term projections on fiscal sustainability over several decades. These long-term projections are then used as fundamental information that guides actual fiscal management. By setting up such an institution, the market's trust in the government's commitment can be strengthened.

To add a final note, the shift from the conventional standard theory of fiscal sustainability, which says "a fiscal surplus is necessary", to the new "stable government bond bubble theory", which says "as long as there's enough discipline to maintain credibility, a large fiscal surplus isn't needed", could be a major paradigm shift in fiscal management. To put it in perspective, it's a paradigm shift comparable to the global monetary system moving from the gold standard to a managed currency system. Even when the gold standard broke down, market economies found a new equilibrium and followed a reasonably stable path. What the new theory suggests about fiscal management is that even if the constraint of running a surplus is removed, market economies will somehow find a stable equilibrium path. We can have more faith in the resilience of market economies.

4. Conclusion: the Historical Role of Rebuilding Liberalism & Growth Strategies

The history of liberalism since the modern era has been like a swinging pendulum, moving back and forth over the inequalities brought about by the development of a market economy. The laissez-faire approach of 19th-century classical liberalism left extreme disparities unchecked, and after the disasters of two world wars and the Great Depression in the 20th century, there was a forced shift toward a welfare-state approach that prioritized reducing inequality through government intervention. However, the rigidity caused by an oversized state led, from the late 1970s onward, to the rise of neoliberalism, which rejected government intervention and placed supreme value on market competition. While this trend helped grow the global economy, it also accelerated the concentration of wealth to the extreme, creating divisions and crises in civil society that are hard to bear today. The rise of the "apocalyptic fascism" discussed in Section 1 is a natural consequence of the structural exhaustion of neoliberalism.

Looking at the flow of history as a whole, we're at a turning point where government intervention is needed to fix inequality and stabilize society. But history has shown that a command economy isn't the answer. The best solution could be "growth-oriented liberalism", which opens up new paths while keeping a free global economy. This means the government boldly invests in basic research and cutting-edge innovation through fiscal policy, expanding the macroeconomic pie to boost people's lives and reduce inequality at the same time. The key policy driving this engine is the "growth strategy".

Modern growth strategies aren't just temporary economic stimulus measures. They have to be a long-term national vision that aligns with fiscal sustainability, backed by the "intrinsic value of government bonds" and "market confidence in fiscal policy" looked at in Section 3. Whether they really succeed depends on whether we can effectively tackle issues like inequality and stagnant living standards while making the most of market mechanisms.

If Japan can present a new growth-oriented liberal model to the world, it could make a big impact on the confusing global society. A growth strategy corrects inequality through growth. Or it effectively pushes forward inequality correction through the distribution of resources necessary for growth. By doing so, it restores social stability, suppresses the pathologies of populism and fascism that eat away at liberalism from within, and passes on an open economic society to the next generation. This is another historical role entrusted to growth strategy, in addition to the formal goal of achieving high economic growth rates.

References

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